LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
SEP [illegible] 1968
JOHN F. DAVIS, CLERK

NO. 270

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

Paul Penjaska and John Penjaska, Appellants

V.

Goodbody & Company

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MICHIGAN

APPELLANTS' BRIEF IN OPPOSITION TO MOTION TO DISMISS

Paul Penjaska
2220 W. Mason Rd.
Owosso, Mich. 48867

John Penjaska
2220 W. Mason Rd.
Owosso, Mich. 48867

INDEX

	PAGE
STATEMENT OF CASE ----------	3
ARGUMENT ----------	4
CONCLUSION ----------	12

CITATIONS

CASES:

Colonial Realty Corp. v. Bache & Co.
U.S. District Court, Southern District of New York, No. 63, Civil 2240 - 1964.

Colonial Realty Corp. v. Bache & Co.
358 Fd 178 - 1966.

Rospigliosi v. Clougher. 46 South. 2d 170

Hammond v. Whittredge. 204 U.S. 538

Anderson v. Brand. 303 U.S. 95

Southwestern Bell v. Oklahoma. 303 U.S. 206

Foreman v. Holsman. 10 Ill. 2d 551

Gulley v. First National Bank in Meridian.
299 U.S. 109

Fifth Ave. Coach Lines, Inc. v. New York Stock Exchange 270 N.Y.S. 2d 852. 1966

Staley v. Salveston 35 D & C. 2d 318
Penna. 1963

Atlas Tack v. New York Stock Exchange
246 F. 2d 311

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1968

NO. 270

Paul Penjaska and John Penjaska, Appellants

V.

Goodbody & Company

ON APPEAL FROM THE MICHIGAN SUPREME COURT

APPELLANTS' BRIEF IN OPPOSITION TO MOTION TO DISMISS

Appellee Goodbody & Co. bases its Motion To Dismiss appellants' Appeal on claim that the appeal does not present a substantial Federal question and that the judment of the Courts of the state of Michigan rests on adequate non-federal basis.

The questions presented by appellants in their Jurisdictional Statement concerned the validity of the contract between the parties under Section 29 (validity of Contracts) and other applicable provisions of the Act and whether jurisdiction of appellee's original suit was exclusive under Section 27 of the Act.

STATEMENT OF CASE

Inaccuracies and Omissions in Appellee's Statement -

The appellants Penjaska take exception to appellee's Statement of Facts as contained in appellee's Motion to Dismiss, There are several inacurracies and omissions by appellee regarding the pertinent facts of this case.

Appellee Goodbody & Co. omits showing the deterioration of appellants stock account and the over-extension of credit by appellee to appellants on the Studebaker-Packard when-issued securities during the period Feb. 3, 1960 to March 8, 1960. The status of the account and other pertinent facts are correctly set forth in appellants Jurisdictional Statement, pages 7 and 8 (Statement of Case). These facts are adequately supported by the Opinion of the trial court and by the Record. (Plaintiff's Declaration, R., Vol. I) (T.89-93).

On page 4 of appellee's Motion to Dismiss, appellee states:

> " The margin on said account remained sufficient until on or about Feb. 3, 1960 when the margin account call was made " -------

This is in error. Nothing in the Record shows that a margin call was made on Feb. 3, 1960. On the contrary, the Opinion of the trial court states:

> " Beginning with Feb. 3, 1960 the account needed margin but the account was not called. "

ARGUMENT

OVER-EXTENSION OF CREDIT BY APPELLEE TO APPELLANTS.

The status of the appellants account during the period Feb. 3, 1960 until March 8, 1960 shows that appellee Goodbody & Co. over-extended credit to appellants on securities registered on a national exchange beyond the time permitted by the minimum margin rules of the New York Stock Exchange, which are rules of an exchange required under section 19(b) and were made applicable to the Studebaker-Packard when-issued securities by the Securities Exchange Commission's rule 12F-1 of 17 CFR 240 promulgated pursuant to section 12(f) of the Act.

On March 8, 1960, when appellee first called for margin, the appellants entire deposit of $10,678.04 was already lost and there was a deficit in their account of $2,586.36. The

Opinion of the trial court states:

" Beginning with February 3, 1960 the account needed margin but the account was not called. The stock continued to decline in value and on March 8, 1960, the Plaintiff (appellee) Goodbody & Co. called on defendants (appellants Penjaska) for $8500. which defendants did not pay, but asked for further time. Plaintiff maintains that it sent out a sellout order on March 15, 1960, for sale on March 18th, but at the request of the defendants deferred sale until March 29th at which time the stock was sold, with a resulting loss to plaintiff in the sum of $4,050.79."

This shows that appellee Goodbody & Co. granted to appellants Penjaska an over-extension of credit during the periods Feb. 3, 1960 to March 8, 1960, from March 8, 1960 to March 18, 1960 and from March 18, 1960 until March 29, 1960 ---- all in violation of the minimum margin rules of the exchange, required under the Act.

In Staley v. Salveson (35 D & C 2d 318 Penn.) (1963) the court ruled that failure to liquidate an undermargined account promptly " consituted an unlawful extension and maintenance of credit and plaintiff (broker) cannot prevail. "

MINIMUM MARGIN RULES OF THE NEW YORK STOCK EX. REQUIRED UNDER SECTION 19(b) OF THE ACT

Appellee argues that Section 19(b) (12) does not set exact specifications regarding minimum margin deposits, that this is left to the exchange. Appellee further argues that the specifics governing margin in this case were set and determined by Rule 431

of the New York Stock Exchange not by section 19(b) of the Act and cites the case of Colonial Realty Corp. V. Bache & Co. (No. 63 Civ. 2240, Southern District of New York) in which, appellee says, the alleged violation of such a rule was held not to be a violation of the Act.

Appellee's position is untenable. In the Colonial case (No. 63 Civ. S. D. N. Y.) the alleged violation was not of the minimum margin rule itself, but of a written agreement between broker and his customer whereby the broker was not to sell securities in the customers margin account unless the equity owned fell below the minimum margin requirements of the exchange. There was no violation of the minimum margin rules of the Exchange by the broker in the Colonial case. In the case at bar the equity fell below the minimum margin requirements of the exchange. Thus, this ruling in the Colonial Case (No. 63 Civ. 2240 S. D. N. Y.) relied upon appellee Goodbody & Co. is inapplicable to the instant case.

Under section 19(b) the commission is authorized to impose changes in the rules of an exchange in regard to a variety of matters including minimum deposits on margin accounts (19b-12) if the rules are found by the commssion to be inadequate for public protection.

In Atlas Tack V. New York Stock Exchange (246 F. 2d 311) the court said:

> " Section 19(b) authorizes the commission after appropriate procedural steps, to impose upon exchanges, or rules of the exchanges, such rules as the commission deems necessary for public protection with reference to a variety of matters.

If the protection there accorded the public is inadequate due to faulty rules or procedures of exchanges, the remedy lies in a correction of these rules and procedures by the method set forth in section 19(b)."

Thus, the specifics in regard to minimum margin deposits are not solely set or determined by the rules of the exchange but can be changed or modified by the Commission if they are found to be inadequate for public protection. Therefore, the exchange's Minimum margin rules are rules of an exchange required under the Act.

The Colonial case cited by appellee (No. 63 Civ. 2240 S. D. N. Y.) was appealed, Colonial V. Bache & Co. (358 F. 2d 178) (1966). The court had this to say:

> " We cannot ignore that the concept of supervised self-regulation is broad enough to encompass a rule which provides what amounts to a substitute for regulation by the SEC itself. Not content with insisting upon Commission approval of exchange rules as a prerequisite to registration under section 6 and 15A, congress authorized the agency to request modification of particluar rules or to promulgate superceeding regulations on its own. A particular stock exchange rule could thus play an integral part in SEC regulation not withstanding the Commission's decision to take a back-seat role in its promulgation and enforcement and we would not wish to say that such a rule could not provide the basis of implying a private right of action. "

VALIDITY OF CONTRACTS

Appellee argues that a violation of the mimimum margin rule (Rule 431) of the New York Stock Exchange which sets the 25% minimum deposit and 25% minimum maintenance of that deposit on the when-issued securities, does not render a contract void, citing the case of Rospigliosi v. Clougher (46 South 2d 170) as upholding this contention. However, the exchange rule in the Rospigliosi case alleged to be violated was one which prohibits an employee of the broker from being interested in a customer's account.

" If there is any such regulation under the provisions of the Act with reference to an employee's interest in a customer's dealings no one has cited it." said the Florida Supreme Court. The court further held that for a contract to be void, the waiver must effect a provision of the Act, or rule or regulation thereunder, or rule of an exchange required thereby.

In contrast to the Rospigliosi suit, the basis of the contrversy in the case at bar involves the minimum margin rules of the exchange which are explicitly referred to under section 19(b) of the Act and rules and regulations thereunder and are therefore " rules of an exchange required thereby ".

The Opinion of the trial court states that proper demand was made on March 8, 1960 when appellee Goodbody Co. first called for margin although the account had been undermargined since February 3, 1960. Appellants feel it is pertinent to point out to the court that this was a determination of law, not of fact. Necessarily, this is a different finding as to what constitutes proper demand for margin if the contract is interpreted under non-Federal law then if interpreted under the

provisions of the Securities Exchange Act of 1934.

The question therefore is reduced to: did the contract between appellants Penjaska and appellee Goodbody & Co. contain " any stipulation or provision binding any person to waive compliance with ---- rule of an exchange required thereby"?

Paragraph 3 of Customer's Agreement (Defendants' Exhibit A item II, Vol. II of Record) (T. 62-63 and T. 83-84) states that customer (appellants) agreed to maintain the margin and that they would be liable for any deficit. (presumably even for a deficit arising out of a broker's violation of the Act.)

The trial court ruled (T. 94-96) (Opinion) that the contract stipulated that appellants agreed to maintain the margin; that appellee did not have to sell securities in the account if it remained undermargined since appellants agreed to protect their own account; and that appellants are liable for any deficiency even though appellee did not abide by the minimum margin rules of the New York Stock Exchange.

The contract, therefore, bound appellants to waive their protection under the Act and they were denied their rights. Section 29(a) makes contract void under the non-waiver provisions.

But appellee argues that appellants' pleadings in regard to the validity of the securities contract under section 29 (Validity of Contracts) constitutes merely a charge of simple breach of contract and that state statutes and common law were sufficient to provide a remedy; appellee further argues

that any reference to the Act by appellants in regard to validity of the contract was merely an "excrescence or superfluity " tacked on to an otherwise common law claim.

The astutness of appellee Goodbody & Co. through its attorneys in bringing its claim arising through over-extension of credit on a national exchange and bringing it under state law and contending therefrom that any defense claimed by appellants constituted a common law claim was based upon the contention that protection afforded the investing public under the Securities Exchange Act does not apply to customers in his dealings with his broker.

Section 29 of the Act is a Federal statutory provision regarding the validity of contracts involving securities. Appellants, as outlined in their Jurisdictional Statement, claimed in their pleadings throughout the Michigan Courts that the contract between the parties was void in regard to the rights of appellee Goodbody & Co. since appellee violated certain provisions - minimum margin maintenance regulations- of the Act. This is a Federal Claim. It was referred to and was a element in the decision of the highest court of the State of Mich. Normally, these are the only requisites for review by the U. S. Supreme Court of a civil case coming from a state court. (Hammond v. Whittredg 204 U.S. 538) (Anderson v. Brand 303 U.S. 95) , (Southern Bell V. Oklahoma 303 U.S. 206).

Appellee argues that appellants claim in regarding the validity of the contract do not present a substantial Federal question.

The appellants believe that if the decision of the Michigan Courts is allowed to stand

it will virtually nullify the protection to the investing public which the Securities Exchange Act of 1934 provides. In similiar circumstances the Supreme Court of Illinois ruled in Foreman v. Holsman (10 Ill. 2d 551) that the states blue sky law together with its voidability provision had been enacted " for the protection and benefit of the public as a whole " and concluded that permitting a waiver or " release " of this statutory voidability provision prior to or contemporaneously with the sale ---- would pave the way for virtual nullification of this important legislative enactment".

EXCLUSIVE FEDERAL JURISDICTION

Appelle Goodbody & Co. argues that it's pleadings and compaaint in the state courts consituted an action in debt and wasupon the common counts for debt over which the trial court of the state of Michigan had jurisdiction.

However, appellee's original suit is upon a contract involving registered securities traded upon a national exchange. Such a contract must comply to specifications as set forth in section 29 (Validity of Contracts) and other applicable sections of the Act. The contract has its gensis, therefore, in the Securities Exchange Act of 1934. Its enforcement has a distinct connection with the existence of a controversy arising under Federal Law. (Gully v. First National Bank in Meridian, 299 U.S. 109).

The subject matter contained in appellee's Declaration (Vol. I of Record) falls within an area pre-empted by the Federal Government. (Fifth Ave. Coach Lines, Inc. v. New York stock Exchange, 270 N. Y. S. 2d 352) (1966).

The opinion of the trial court that plaintiff (appellee Goodbody & Co.) had pleaded no federal claim was based upon the ruling in Colonial Realty v. Bache & Co. (U.S. D.C., S.D. N. Y.) Nov. 6; Civil 2240. However, this case is inapplicable to the case at bar since the alleged violation in the Colonial case was not of a rule of an exchange required by a provision of the Act or rules or regulations thereunder.

CONCLUSION

The questions pretaining to validity of contract and exclusive federal jurisdiction under the Securities Exchange Act of 1934, as outlined in appellants' Jurisdictional Statement, are substantial and properly before the court. If the order of the Mich. Supreme Court is allowed to stand it will pave the way for virtual nullification of this important legislation.

Probable jurisdiction should be noted.

Paul Penjaska
Paul Penjaska
2220 W. Mason Rd.
Owosso, Mich. 48867
John Penjaska
John Penjaska
2220 W. Mason Rd.
Owosso, Mich. 48867

Date: 29 August 1968